BANKRUPTCY REFORM/Good Faith of Creditors

SUBJECT: **Consumer Bankruptcy Reform Act . . . S. 1301. Hatch motion to table the Reed amendment No. 3610 to the Grassley/Hatch substitute amendment No. 3559 to the committee substitute.**

ACTION: MOTION TO TABLE AGREED TO, 63-36

SYNOPSIS: As reported with a substitute amendment, S. 1301, the Consumer Bankruptcy Reform Act, will enact reforms to prevent creditors who have the means of paying their debts from unjustly filing for bankruptcy, and will enact reforms to protect consumers from unfair credit practices.

The Grassley/Hatch substitute amendment would retain the underlying substitute amendment's provisions and would add provisions relating to business bankruptcies.

The Reed amendment would require a bankruptcy judge, when deciding whether to grant a motion for dismissal or conversion by a creditor, to consider whether that creditor "dealt in good faith" with the debtor.

(Background: Under current law, individuals considering bankruptcy generally proceed under Chapter 7 or Chapter 13. Under Chapter 7, the debtor surrenders those assets which do not qualify for an exemption under the law, and the assets are sold to satisfy (in part) the demands of the creditors. Any deficiency which remains after the sale of the assets is erased ("discharged"). Chapter 13, on the other hand, provides for the development of a repayment plan to repay a portion of the debtor's debts using future earnings. When the debtor has made his payments as required under the repayment plan, any unpaid portion of his debt is discharged. Prior to 1984, an individual contemplating bankruptcy could freely choose between Chapter 7 and Chapter 13. However, in an effort to address concerns about misuse of Chapter 7 by those with the means to repay some of their debts, Congress amended the bankruptcy code in 1984 so that a Chapter 7 bankruptcy case could be dismissed if it involved "substantial abuse" of the law. However, only the judge or the bankruptcy trustee, not a creditor, could make a motion alleging "substantial abuse." The 1984 changes did not reduce the rapid increase in the number of Chapter 7 cases. This bill will make four changes intended to stop the misuse of Chapter 7 proceedings. First, it will allow a bankruptcy judge to dismiss a Chapter 7 case (or convert it into a Chapter

(See other side)

YEAS (63)

Republicans (54 or 98%)		Democrats (9 or 20%)
Abraham	Helms	Biden
Allard	Hutchinson	Breaux
Ashcroft	Hutchison	Graham
Bennett	Inhofe	Johnson
Bond	Kempthorne	Kohl
Brownback	Kyl	Landrieu
Burns	Lott	Lieberman
Campbell	Lugar	Reid
Chafee	Mack	Robb
Coats	McCain	
Cochran	McConnell	
Collins	Murkowski	
Coverdell	Nickles	
Craig	Roberts	
D'Amato	Roth	
DeWine	Santorum	
Domenici	Sessions	
Enzi	Shelby	
Faircloth	Smith, Bob	
Frist	Smith, Gordon	
Gorton	Snowe	
Gramm	Specter	
Grams	Stevens	
Grassley	Thomas	
Gregg	Thompson	
Hagel	Thurmond	
Hatch	Warner	

NAYS (36)

Republicans (1 or 2%)	Democrats (35 or 80%)	
Jeffords	Akaka	Inouye
	Baucus	Kennedy
	Bingaman	Kerrey
	Boxer	Kerry
	Bryan	Lautenberg
	Bumpers	Leahy
	Byrd	Levin
	Cleland	Mikulski
	Conrad	Moseley
	Daschle	Braun
	Dodd	Moynihan
	Dorgan	Murray
	Durbin	Reed
	Feingold	Rockefeller
	Feinstein	Sarbanes
	Ford	Torricelli
	Harkin	Wellstone
	Hollings	

NOT VOTING (1)

Republicans (0)	Democrats (1)
	Glenn-[2]

EXPLANATION OF ABSENCE:
1—Official Business
2—Necessarily Absent
3—Illness
4—Other

SYMBOLS:
AY—Announced Yea
AN—Announced Nay
PY—Paired Yea
PN—Paired Nay

13 case if the petitioner consents) if the system is being "abused" (*not* "substantially abused" as under current law). Second, it will allow any party in interest (creditors) to allege abuse. Third, in considering whether there has been abuse of the system, the court will consider: whether the bankruptcy petition was filed in bad faith; or whether the debtor, based on his current income, can repay at least 20 percent of his general unsecured debts. Fourth, if a judge determines that a Chapter 7 filing is substantially unjustified, then that judge will be allowed to order a debtor's attorney to pay court costs related to that filing, and, if a judge rejects a creditor's challenge of a Chapter 7 filing, then that judge will be allowed to order the creditor to pay the debtor's costs related to that challenge.)

Debate was limited by unanimous consent. After debate, Senator Grassley moved to table the Reed amendment. Generally, those favoring the motion to table opposed the amendment; those opposing the motion to table favored the amendment.

Those favoring the motion to table contended:

The main reforms to stop the abuse of the bankruptcy system that are in this bill are the reforms to stop unjust Chapter 7 filings. People who are capable of paying back part of their debts under Chapter 13 proceedings, or who do not really need bankruptcy protection at all, have been using Chapter 7 to escape paying back any of the money they owe. Congress tried to stop this practice in 1984, but the measures it passed were not strong enough to have any demonstrable effect. Therefore, under this bill, judges will be given broader discretion to stop abusive filings, and creditors will be given a chance to challenge Chapter 7 filings before they lose all of their money. Perhaps most importantly, for those debtors whom a bankruptcy judge believes have acted in bad faith, a "means test" will be employed: a debtor who is able to repay at least 20 percent of the money he owes will not generally be considered a candidate for Chapter 7. With the Reed amendment, our colleagues now also want the bankruptcy judge to consider whether the credit should have been extended in the first place. In other words, our colleagues contend that if a company gave money to someone whom it had reason to believe would go broke, then it should not be able to get any of its money back, even if that person had the ability to repay. We frankly have some sympathy for that proposition. Some credit card companies are giving people credit who should not be receiving it, and some companies have engaged in unfair lending practices. We note that this bill contains numerous provisions to stop abuses by such companies. For instance, if a creditor refuses to negotiate in good faith with a debtor, then that debtor is not allowed to object to the discharge of his or her debt. However, the intent of the Reed amendment aside, in practice it would be unworkable. How would a judge even find out what the creditors underwriting practices were? What would happen if one creditor who asked for dismissal had acted in bad faith, and another creditor who asked for dismissal had acted in good faith? What would a judge do if he found that a credit card company had poor lending practices, but in the particular case of a debtor before him it had properly extended credit? This amendment would basically throw a huge question mark into the middle of the major Chapter 7 reforms in this bill. If we agree to this amendment, we may well find that in practice we will have again failed to enact effective reforms. We are very willing to address the subject of lending to poor credit risks, but not in this context. The Reed amendment should be tabled.

Those opposing the motion to table contended:

The bankruptcy system is being abused by people to escape debts that they are capable of repaying, and we firmly favor the reforms in this bill to stop that abuse. However, the problem of soaring bankruptcies is not solely due to such unethical behavior. The credit industry must also accept a large share of the blame. Total household debt has gone up tremendously (from 24 percent of aggregate household income to 104 percent today) largely because credit has been so aggressively marketed, often to people whom the credit card companies have known are not capable of repaying. In recent years, virtually all Americans have been deluged with credit card solicitations. A recent Wall Street Journal article about a California family detailed how it had received credit solicitations in just one year that totalled $5 million. Most of the companies have been reputable, but a few have targeted senior citizens, low-income Americans, and others who are especially vulnerable to falling for unscrupulous marketing techniques. For instance, one recent practice that has been used almost exclusively in low-income areas has been to mail residents "checks" that they can sign to get cash, but that leave them with debt at usurious interest rates. A company that is engaging in that type of lending is clearly dealing in bad faith. It does not perform credit checks before offering loans; it fully expects its borrowers to get into financial difficulties that they cannot handle. Under this bill, such lenders will be able to go into bankruptcy proceedings and demand that they be moved to Chapter 13 if their borrowers still have some money left. In other words, if their unscrupulous practices have not bled their victims dry, they will be able to get bankruptcy judges to help them squeeze out the last little bit of money. We do not believe that is just. Bankruptcy judges should also be required to determine if a lender who asks for the dismissal or conversion of a Chapter 7 proceeding acted in good faith when it lent the money. If not, its request should be denied. This proposal is eminently fair. We urge our colleagues to support the Reed amendment.